KIRAMES SDN. BHD.

v.

FEDERAL LAND DEVELOPMENT AUTHORITY

HIGH COURT MALAYA, KUALA LUMPUR
ZAKARIA YATIM J
[CIVIL SUIT NO. C22-118-86]
7 NOVEMBER 1990

ARBITRATION: *Injunction - Setting aside - Consent order granting the defendant liberty to stay proceedings pursuant to provisions of the Arbitration Act - Whether defendant is entitled to proceed with application to set aside injunction - Arbitration Act 1952, ss. 1, 6, 34.*

CONTRACT: *Security deposit - Whether it arose from a separate contract - Whether defendant entitled to have performance guarantee honoured - Exceptions - Fraud - Principles applicable - Whether security is a performance bond.*

Under an agreement dated 3 October 1985 the defendant, Felda, agreed to supply to the plaintiff, K, reinforced concrete spun pipes. As a condition precedent to the execution of the said agreement K was required to deposit with Felda a sum equivalent to 5% of the value of the contract.

K obtained and delivered the security guarantee which was issued by Jerneh Insurance Corporation Sdn. Bhd., J, and addressed to Felda as beneficiary.

The guarantee was given by J on behalf of K for the due performance of the contract.

K filed a writ of summons against Felda and on the same day 6 May 1986, K obtained are *ex parte* injunction dated 6 May 1986 against Felda which prohibited Felda from doing any act in relation to the agreement and prohibited them in any way applying to J for the enforcement of the security deposit for forfeiting the deposit until disposal of the writ.

The agreement between the parties contained a clause to the effect that any dispute was to be referred to arbitration. The Court then made a consent order on 21 August 1986 granting Felda liberty to stay the proceedings under the Arbitration Act.

Felda now applies to set aside the injunction granted to K.

The issue before the Court was whether Felda, after obtaining the consent order, is entitled to proceed with the application to set aside the injunction.

Held:

[1] Felda is still at liberty to proceed with the application to set aside the injunction even though a consent order for stay of proceedings had been obtained. It is entitled to ask for an interlocutory injunction or to apply to set aside an *ex parte* injunction even before an order for stay of proceedings was obtained that is, at the stage when the applicant must not take any other steps in the legal proceedings.

[2] It is clear that the above document is a guarantee given by J on behalf of K for the due performance of the contract dated 3 October 1985. The guarantee is an "on-demand" guarantee and it is a performance guarantee or performance bond.

[3] The security deposit arose from a separate contract between Felda and a 3rd party, J; further, as no question of fraud was raised in this case, Felda is entitled to demand payment under the said guarantee and J is required to honour the guarantee according to its terms.

[Injunction set aside; damages to be assessed and paid by K to Felda.]

Cases referred to:
Bolivinter Oil SA v. Chase Manhattan Bank [1974] WLR 392
Edward Owen Engineering Ltd. v. Barclays Bank International Ltd. [1978] 1 All ER 976
Hamzah Malas & Sons v. British Imex Industries Ltd. [1958] 2 QB 127
Howe Richardson Scala Co. Ltd. v. Polimex-Cekopp & National Westminster Bank Ltd [1978] 1 Lloyd's Rep 16
Intraco Ltd. v. Notis Shipping Corporation (The Bhoja Trader) [1981] 2 Lloyd's Rep 256
R.D. Harbottle (Mercantile) Ltd. v. National Westminster Bank Ltd. & Ors. [1977] 2 All ER 802
Roussel - Uclaf v. G.D. Searle & Co. Ltd. [1978] FSR 95
United Trading Corporation SA & Murray Clayton Ltd. v. Allied Arab Bank Ltd. [1985] 2 Lloyd's Rep 554
Queens College Kanetra v. The Collector [1974] AIR All 431

Legislation referred to:
Arbitration Act 1952, ss. 1, 6, 34

Other sources referred to:
Arbitration by S.D. Singh, 8 Edn., p. 614
Dictionary of Banking Terms 1990 by TP Fitch, p. 459
Law of Banking 1989 by Poh Chu Chai, p. 477
Russell on Arbitration 20 Edn., at p. 29

For the plaintiff or respondent - K. Satchiananda Manickam; M/s. Satchi and Co.
For the defendant or appellant - S. Navaratnam; M/s. Ranjit, Thomas & Kula

JUDGMENT

Zakaria Yatim J:

In this application the defendant is asking the Court to make the following order:

(1) that the injunction granted *ex parte* to the plaintiff on 6 May 1986, be set aside;

(2) that an enquiry be ordered to be made by the Senior Assistant Registrar as to damages suffered by the defendant as a result of the injunction and that the plaintiff be ordered to pay such damages as assessed to the defendant.

(3) the costs of and incidental to the application be paid by the plaintiff.

The restraining order granted *ex parte* on 6 May 1986, states, *inter alia*, as follows:

> **It is ordered** that the defendants by themselves, their servants, agents or otherwise howsoever be restrained by an injunction from doing any act of whatsoever nature in relation to an agreement entered into between the plaintiffs as the suppliers and the defendants as the Authority dated 3 October 1985, or in any way affecting the same or in any applying to M/s. Jerneh Insurance Corporation Sdn. Bhd. for the enforcement of the security deposit or forfeiting the said deposit till the disposal of this civil suit **and it is ordered** that the defendants by themselves, their servants, agents or otherwise howsoever be restrained by an injunction from doing any act of whatsoever nature in relation to the security deposit and maintain the status quo *vis-a-vis* the plaintiffs and defendants pending the outcome of this civil suit.

The defendant, in its affidavit affirmed on 22 May 1986, in support of the application to set aside the above order avers that the plaintiff's claim in this action was based on an agreement No. C-232485-vs OSP. Under clause 16 of the general conditions of the said agreement, any dispute arising out of the said agreement should be referred to arbitration within the meaning of the Arbitration Act 1952. The plaintiff had not resorted to this step but had commenced the present proceedings. The defendant was prepared and willing to submit the matter to arbitration under the terms of the said agreement.

It is not in dispute that the said agreement was entered into between the plaintiff and the defendant on 3 October 1985. Clause 16 of the general conditions of the agreement is the arbitration clause and it reads as follows:

> 16. Any dispute or difference arising out of this contract shall be referred to the arbitration of a person to be mutually agreed upon between the supplier and the Authority and failing agreement to some person appointed on the application of either of the parties to the contract by the President for the time being of the institution named in the appendix. This shall be deemed to be a submission to arbitration within the meaning of the Arbitration Act 1952 (Act 93 - Revised 1972) or any statutory modification thereof for the time being in force.

On 21 August 1986, the Court made a consent order granting the defendant liberty to stay proceedings in this suit pursuant to the provisions of the Arbitration Act.

At the hearing of the application to set aside the injunction, Mr. K. Satchiananda, Counsel for the plaintiff raised a question as to whether the defendant could proceed with the hearing of the application or whether the Court had the power to set aside the injunction when a stay of proceedings had been granted by the Court on the application of the defendant. He then referred to *Russell on Arbitration* 20 Edn. at p. 297 where the learned author said,

> In addition to its powers to make orders relating to merely procedural matters, the Court has wide powers to make orders for the purpose of preserving the **status quo** pending arbitration.

He submitted that if the injunction was dissolved then the purpose of going to arbitration would be defeated.

Miss S. Navaratnam, Counsel for the defendant, referred to the same passage in Russell on Arbitration and submitted that the Court had the power to grant interlocutory and auxiliary relief. Accordingly, she said, this Court had jurisdiction to hear the defendant's application to set aside the injunction.

The issue before the Court is whether the defendant, after obtaining the consent order dated 21 August 1986, is entitled to proceed with the application to set aside the injunction.

Under s. 6 of the Arbitration Act, a party to a proceeding may, before taking any other steps to the proceedings, apply to the Court for a stay of the proceedings to enable parties to the proceedings to refer their dispute to arbitration.

In the present case, the plaintiff filed a writ of summons against the defendant on 5 May 1986. On the same day the plaintiff filed an *ex parte* application and on 6 May 1986, obtained the injunction against the defendant.

In my opinion, although a consent order for stay of proceedings has been obtained, the defendant is still at liberty to proceed with the application. Even before an order for stay of proceedings was obtained, that is, when the applicant must not take any other steps in the legal proceedings, it is entitled to ask for an interlocutory injunction or to apply to set aside an *ex parte* injunction. In *Roussel - Uclaf v. G. D. Searle & Co. Ltd* [1978] FSR 95 the Court decided as follows:

(5) By the words "after appearance and before delivery of any pleadings or taking any other step in the proceedings", s. 1 of the Arbitration Act contemplated some positive procedural act by way of offence on the part of the defendant rather than merely parrying a blow by the plaintiff, particularly where the attack consisted of asking for an interlocutory injunction (p. 105).

In *Queens College Kanetra v. The Collector* AIR [1974] All 431, Mathur J said, at pp. 432 and 433:

I am unable to accept the contention that taking steps to set an *ex parte* injunction vacated amounts to taking such a step in the suit as would disentitle the defendants for applying for stay under s. 34.

S.D. Singh on Arbitration, 8 Edn. p. 614 states:

While the Court has power to issue an interim injunction during the course of an arbitration proceeding it will also have power to entertain an application for setting aside an *ex parte* injunction, even though the suit in which the *ex parte* injunction was passed, may have been stayed under s. 34.

Having decided that the defendant can proceed with the application to set aside the injunction, the next point to consider is whether the injunction should be set aside. As already stated, the injunction restrained the defendant from enforcing the security deposit or forfeiting the said deposit. Miss Navaratnam rightly submitted that the security deposit arose from a separate contract between the defendant and a third party. She cited two cases on this point *viz. Bolivinter Oil SA v. Chase Manhattan Bank* [1984] WLR 392 and *R.D. Harbittke (Mercantile) Ltd. v. National Westminster Bank Ltd. & Ors.* [1977] 2 All ER 802. In *Edward Owen Engineering Ltd. v. Barclays Bank International Ltd.* [1978] 1 All ER 976 the English Court of Appeal decided that, where a bank had given a performance guarantee, it was required to honour the guarantee according to its terms. According to the Court the only exception was that where fraud by one of the parties to the contract had been established and the bank had notice of the fraud. No question of fraud was raised in that case. In his judgment in that case at p. 983, Lord Denning MR said:

All this leads to the conclusion that the performance guarantee stands on a similar footing to a letter of credit. A bank which gives a performance guarantee must honour that guarantee according to its terms. It is not concerned in the least with the relations between the supplier and the customer; nor with the question whether the supplier has performed his contracted obligation or not; nor with the question whether the supplier is in default or not. The bank must pay according to its guarantee on demand if so stipulated, without proof or conditions. **The only exception is when there is a clear fraud of which the bank has notice.** (Emphasis added).

Ackner LJ, as he then was, in his judgment in *United Trading Corporation SA & Murray Clayton Ltd. v. Allied Arab Bank Ltd.* [1952] 2 Lloyd's Law Reports 554 described *Edward Owen's* case as:

the *locus classicus* for the proposition that a performance bond, standing on a similar footing to a letter of credit obliges a bank to honour it according to its terms, unless it has notice of clear fraud committed by the beneficiary.

In the present case the document in question is called "security guarantee" and in the agreement dated 3 October 1985, it is referred to as "security deposits." The question that arises here is whether a security guarantee or security deposit document can be treated in the same manner as performance guarantee or performance bond. A performance guarantee

or performance bond is a guarantee given by a bank on behalf of its customer that the customer will duly carry out the contract of sale. See Poh Chu Chai, Law of Banking 1989 p. 477. A performance bond may be purchased from an insurance company. See T.P. Fitch, Dictionary of Banking Terms 1990, p. 459. There are two types of performance bond - a conditional performance bond and an "on-demand" performance bond.

I shall now examine the position in the present case.

Under the agreement dated 3 October 1985, between the plaintiff and the defendant, the defendant agreed to supply to the plaintiff reinforced concrete spun pipes to Felda Kalabaka Complex, Sabah for a total contract price of RM2,350,700 for the period from 6 August 1985, to 31 May 1986. As a condition precedent to the execution of the said agreement the plaintiff was required to deposit with the defendant a sum equivalent to five percent of the value of the contract which was RM117,557. On the question of security deposit, clause 2 of the said agreement provides:

> 2(a) The supplier shall as a condition precedent to the execution of the agreement of this contract, deposit with the authority a sum equivalent to the amount referred to in the appendix in cash or by way of a banker's guarantee which shall in any event be equivalent to 5% of the value of the contract price which guarantee shall be in a form to be prescribed by the authority and which deposit shall hereinafter be referred to as "the security deposit." It is agreed that the authority may utilise and make payments out of or deductions from the said security deposit in accordance with the terms of this contract.
>
> (b) The security deposit (or any balance remaining to the credit of the supplier) shall be released within the period stated in the appendix from the date of expiry of the contract.
>
> (c) The security deposit (or any balance thereof remaining to the credit of the supplier) shall be forfeited to the authority at any time in the event of any breach of the terms, covenants, conditions and stipulations on the supplier's part to be performed or observed in this contract.

Pursuant to the above condition, the plaintiff obtained and delivered to the defendant a security guarantee for the sum of RM117,535 which was accepted by the defendant. The security guarantee, dated 2 October 1955, was issued by Jerneh Insurance Corporation Sdn. Bhd. and addressed to the defendant as the beneficiary. The security guarantee states:

> In consideration of your agreeing to grant Kirames Sdn. Bhd. 4½ m/s, Apas Road, Tawau, Sabah (hereinafter called the paid "contractor") contract bearing No. C232485-VS-O-SP (hereinafter called the said "contract") in respect of supply and delivery of R.C. Span Pipes to Felda Kalabakan Complex, Sabah.
>
> We, Jerneh Insurance Corporation Sdn. Bhd. Ltd., having the registered office at 7 Floor, Wisma MISC, No. 2, Jalan Conlay, Kuala Lumpur do hereby irrevocably and absolutely guarantee that the sum of Ringgit RM117,535 by way of security deposit under the said contract shall be paid to you by us as per the following terms:
>
> (a) the said sum of Ringgit RM117,535 shall be paid by us forthwith on demand by you in writing without your having to assign any reason whatsoever for such demand.
>
> (b) the said sum of Ringgit RM117,535 shall, be paid by us forthwith to you irrespective of whether or not there is any dispute between the said contract and yourselves (the authority) in respect of or relating to the said contract or in respect of any other matter and irrespective of whether or not such said dispute, if any, has been settled, resolved, litigated or adjudicated upon or otherwise howsoever.
>
> This guarantee is effective from 6 September 1985.

It is clear that the above document is a guarantee given by Jerneh Insurance Corporation Sdn. Bhd. on behalf of the plaintiff for the due performance of the contract dated 3 October 1985. The guarantee is an "on-demand" guarantee.

I am satisfied that the above document is a performance guarantee or performance bond.

The next question to consider is whether the plaintiff is entitled to an order restraining the defendant from making a demand for payment in respect of the security guarantee. The cases referred to earlier, *viz. Bolivinter Oil SA v. Chase Manhattan Bank; Harbottle v. National Westminster Bank; Edward Owen; and United Trading Corporation v. Allied Arab Bank*, laid down the principle that the Court will not restrain a bank which gives a performance guarantee, from honouring it according to its terms except when there is a clear case of fraud.

In the present case, however, the injunction was obtained against the defendant. There are authorities which say that the Court will not restrain a defendant who is a party to a contract from making a demand for payment under a letter of credit or under a performance guarantee. In *Hamzah Malas & Sons v. British Imex Industries Ltd.* [1958] 2 QB 127 the plaintiffs contracted to purchase from the defendants a large quantity of reinforced steel rods to be delivered in two instalments. Payments was to be effected by the opening of two letters of credit with a bank. The letters were duly opened and the first letter of credit was realised by the defendants on the delivery of the first instalment. The plaintiffs complained that, that instalment was defective and sought an injunction to restrain the defendants from realising the second letter of credit. The learned Judge refused the application. The plaintiffs appealed and the English Court of Appeal dismissed the appeal. In *Howe Richardson Scala Co. Ltd. v. Polimex-Cekop and National Westminster Bank Ltd* [1978] 1 Lloyd's Report 16 the plaintiff entered into a contract for the sale and delivery of some valuable equipment. The contract price was £500,000 pounds of which £25,000 was payable in advance within 45 days on the signing of the contract on the presentation by the plaintiff bank guarantee. Polimex claimed repayment of RM25,000 under the guarantee on the ground that delivery had not been made. The plaintiff applied for an injunction to restrain Polimex from claiming under the guarantee. The Court of Appeal decided that it would be wrong for the Court to interfere with Polimex's apparent right under the guarantee to seek payment from the bank. See also *Intraco Ltd. v. Notis Shipping Corporation ("The Bhoja Trader")* [1981] 2 Lloyd's Report 256.

Following the authorities I have just cited, I am of the view that the defendant, in the present case is entitled to demand payment under the terms of the security guarantee. There is no evidence of fraud in this case. The injunction granted 6 May 1986, is therefore set aside. The Senior Assistant Registrar will hold an enquiry as to damages suffered by the defendant as a result of the injunction and the plaintiff is ordered to pay such damages as assessed to the defendant. The costs of this application shall be paid by the plaintiff to the defendant.

Also found at [1991] 2 CLJ 1366